



# Burgundy Book

A report on economic conditions in the Louisville zone

First Quarter 2013

The Louisville zone of the Federal Reserve comprises southern Indiana and western Kentucky and a total population of approximately 3.4 million people, including the almost 1.3 million who live in the Louisville MSA.

## Regional economy shows moderate gains; business contacts express slight optimism for 2013

By Kevin L. Kliesen, *Business Economist and Research Officer*

Labor market conditions were mixed in the zone, with some areas reporting strong growth and others reporting little growth or modest declines during the fourth quarter of 2012. Compared with a year earlier, nonfarm employment growth in the Louisville MSA remained strong and well above the nation's growth rate. The Louisville zone's unemployment rate averaged 7.8 percent in the fourth quarter, which equaled the nation's 7.8 percent rate (see map).

In contrast to most other areas, the Louisville MSA experienced strong growth in both the goods- and service-producing sectors. Compared with a year earlier, employment growth during the fourth quarter was especially robust in the trade, transportation, and utilities industry, which employs 23 percent of the MSA's work force.

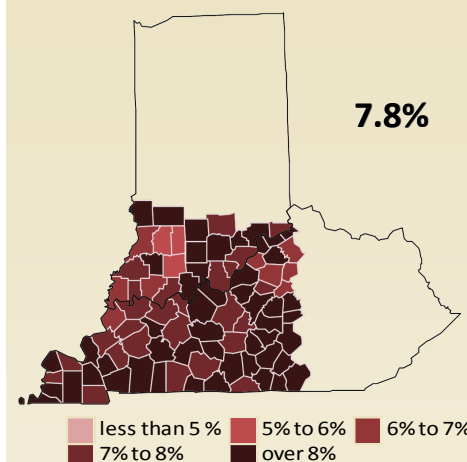
The Louisville MSA outperformed most other areas of the zone in real estate activity during the fourth quarter. In particular, new and existing home sales rose sharply and outpaced the nation's rate by a considerable margin. Gains in house prices and building permits in the fourth quarter were generally weaker.

Per capita personal income growth for Indiana and Kentucky outpaced the nation's growth during the third quarter. Relatively strong income growth coupled with declining mortgage and credit card balances indicates continued improvement in household balance sheets.

Key performance measures suggest that Kentucky and Indiana banks outperformed their Eighth District counterparts and U.S. peers during the fourth quarter of 2012. Significant improvements in asset quality (falling loan delinquency rates) bolstered earnings in the fourth quarter, but bankers in the zone still generally reported soft loan demand.

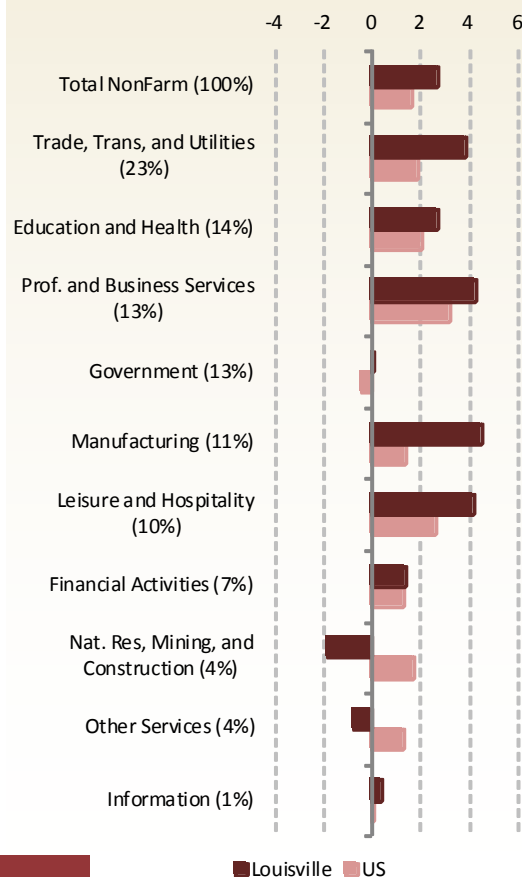
### Data Snapshot

#### County unemployment rates (SA, Q4-12)



#### Nonfarm payroll employment by industry

Percent change from one year ago (Q4-12)



## How to read this report

Unless otherwise noted, **city names** refer to the metropolitan statistical areas (MSAs), which are geographic areas that include cities and their surrounding suburbs, as defined by the Census Bureau.

**Statistics for the Louisville zone** are based on data availability and are calculated as weighted averages of either the 88 counties in the zone or the five MSAs. As of 2012, approximately 60 percent of the zone’s labor force was located in an MSA. Specifically: 39 percent in Louisville, 11 percent in Evansville, 4 percent in Bowling Green, 4 percent in Owensboro, and 3 percent in Elizabethtown; 40 percent of the zone’s labor force was located in non-metropolitan areas.

**Arrows in the tables** are used to identify significant trends in the data. The direction of the arrow indicates the sign (up/down) and the color indicates the economic significance (green = good, red = poor). Arrows appear only when the change from previous quarter is greater than 1 standard deviation. For example, the standard deviation of the change in the U.S. unemployment rate is 0.4 percent. If the U.S. unemployment rate declined from 8.4 percent to 8.2 percent, no arrow would appear; but if it declined from 8.4 percent to 7.9 percent, a green down arrow would appear in the table.

Selected **variable definitions** are located in the appendix.

**Selected quotes** from business contacts are generally verbatim, but some are lightly edited to improve readability.

For more information contact the St. Louis office:

Charles Gascon  
charles.s.gascon@stls.frb.org

Media inquiries:  
mediainquiries@stls.frb.org

## Table of Contents

Labor Markets .....	3
Manufacturing.....	4
Real Estate and Construction .....	5
Household Sector.....	6
Banking and Finance .....	7
Agriculture and Natural Resources .....	8
Public Sector.....	9
Appendix .....	10

## Join our Panel of Business Contacts

The anecdotal information in this report was provided by our panel of business contacts, who were surveyed between February 1 and February 15.

If you’re interested in becoming a member of our panel, follow this link to complete a trial survey:

<http://research.stlouisfed.org/beigebooksurvey/>

Or email us at [beigebook@stls.frb.org](mailto:beigebook@stls.frb.org).

*Views expressed do not necessarily reflect official positions of the Federal Reserve System.*

## Employment Gains Primarily Concentrated in Louisville and Elizabethtown

By Charles S. Gascon, Senior Research Support Coordinator

*“Business conditions are now steady but fragile. There has been improvement in the last 6 months.”*

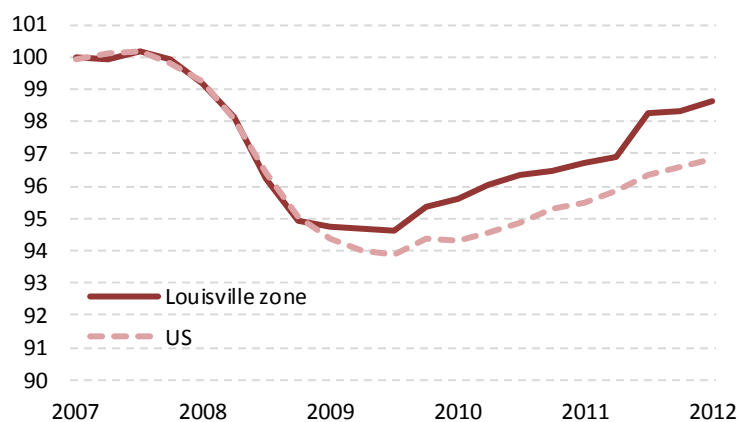
— Western Kentucky banker

*“If the economy slips back into recession due to the fiscal cliff not being resolved, we don't want to lay off newly hired people.”*

— Southern Indiana manufacturer

### Labor market recovery is stronger than the nation

Nonfarm payroll employment, SA (Index 2007=100)



Source: BLS.

- The unemployment rates across the zone remain surprisingly high given relatively strong growth in payroll employment. The average unemployment rate for the zone is about 7.8 percent, which is equal to the national rate. Among the zone’s MSAs, Evansville and Owensboro have the lowest unemployment rates at 7.2 percent.
- Although there are some headwinds stemming from the uncertainty around fiscal policy, 40 percent of business contacts expect to increase employment during the next three months; 50 percent expect hiring to remain unchanged, and only 10 percent expect to decrease employment.
- December data on average weekly earnings growth was generally robust. With the exception of Bowling Green (-0.6 percent), year-over-year growth was positive in all of the zone’s MSAs: Workers in Elizabethtown and Owensboro experienced the strongest gains, at about 25 percent and 14 percent, respectively. Growth in Louisville and Evansville was also strong at 7 percent and 2 percent, registering above the national average of 1.8 percent.
- Anecdotal evidence suggests wage growth should continue: Over 60 percent of business contacts said wages at their firms increased during the first part of 2013; the remaining said wages were unchanged.

	Louisville	Evansville	Bowling Green	Elizabethtown	Owensboro	US
Unemployment rate (Q4-12) (%)	7.9	7.2	7.3	7.8	7.2	7.8
Nonfarm employment (Q4-12)	2.7	0.1	0.6 ▲	2.1 ▲	-0.7 ▼	1.6
Goods-producing sector	2.7	-1.1	-2.1	-1.4	-2.5	1.5
Private service-providing sector	3.2	0.8	1.2 ▲	3.7 ▲	-0.8 ▼	2.2
Government sector	0.1	-1.4	1.1	1.1	1.3	-0.4

Note: Unless otherwise noted, values are percent change from one year ago. Arrows indicate a significant ( $\pm 1$  standard deviation) change from the previous quarter. See appendix for notes and sources.

## Recent Growth Has Slowed, but Outlook Remains Positive

By David Lopez, Senior Research Associate

*“Investment in business expansion and hiring of additional employees is negligible at best.”*

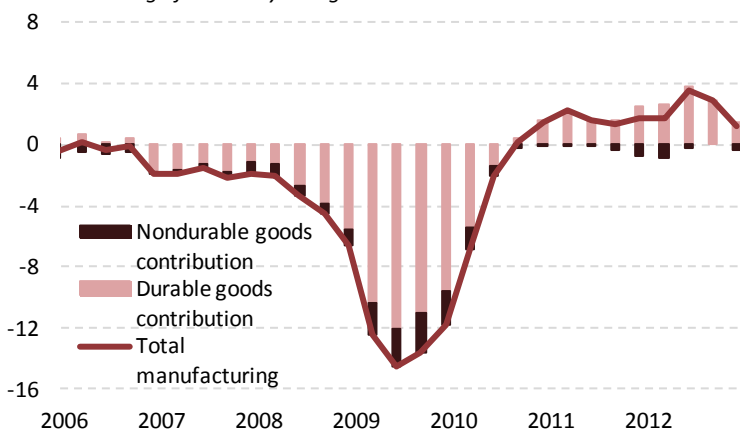
— Southern Indiana manufacturer

*“Fiscal cliff concerns meant a more cautious approach to hiring and capital expenditures in late 2012 and early 2013.”*

— Louisville area manufacturer

### Kentucky's manufacturing employment growth has slowed in recent quarters

Percent change from one year ago



Source: BLS.

- Manufacturing conditions were generally positive in the recent quarter and are expected to continue. The vast majority of manufacturing survey contacts expect general business conditions to remain the same or improve.
- Similarly, respondents also expect new orders, production, sales, and profits to increase over the next 3 months.
- Kentucky’s manufacturing employment has continued on its upward trajectory, albeit at a slower pace (see chart). Survey evidence indicates that this slowing trend will continue, with the majority of manufacturing survey respondents expecting their employment to remain unchanged during the first half of 2013.
- During the recession, manufacturing employment fell sharply, with Kentucky and Indiana experiencing declines of 15 percent or more in 2009. Since then, durable goods employment has been a key driver in employment changes in the Louisville zone; nondurable goods have generally been a drag on employment growth.
- Earnings growth have also been positive in Kentucky and Indiana for the third quarter of 2012. Anecdotal evidence suggests that manufacturing sales and profits also increased during the past three months.

	Louisville	Kentucky	Indiana	US
Manufacturing employment (Q4-12)	4.5	1.2 ▼	4.2	1.2
Durable goods	6.6	2.5 ▼	5.7	1.8
Nondurable goods	1.3 ▼	-0.8	0.5	0.3
Manufacturing earnings (Q3-12)	--	10.4 ▼	8.6	5.4
Durable goods	--	14.0 ▼	11.9	7.5
Nondurable goods	--	4.4	1.6	1.7

Note: Values are percent change from one year ago. Arrows indicate a significant ( $\pm 1$  standard deviation) change from the previous quarter. See appendix for notes and sources.

## Housing Market Gains, While Uncertainty Remains in Office Real Estate

By Li Li, Research Associate

*“The spring sales season appears to have arrived early.”*

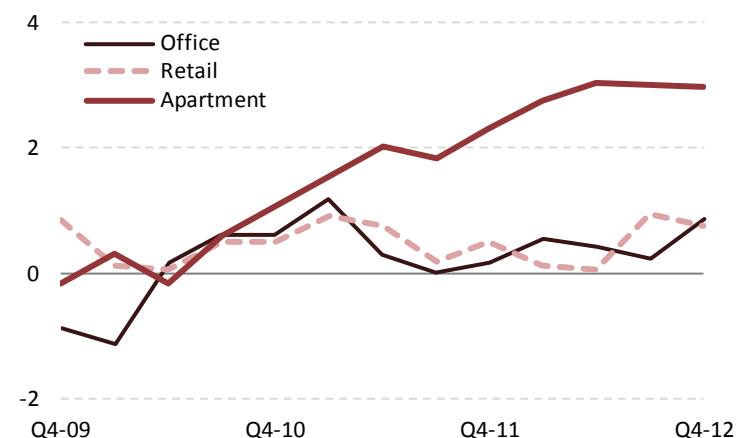
— Louisville area residential realtor

*“Although leasing interest (not new signed leases at this point) has increased, there is still a cautious attitude toward making an investment. There is still a feeling of uncertainty.”*

— Louisville area commercial realtor

### Louisville apartment asking rent growth stabilized

Percent change from one year ago



Source: Reis.com.

- The residential housing market is showing signs of a sustained recovery. Contacts reported that sales volume was up in the fourth quarter and expected to increase in the next quarter.
- Louisville new and existing home sales in 2012 increased by 16 percent on a year-over-year basis, higher than the national rate of 11 percent. Home prices increased across the zone except in Elizabethtown (see table).
- Office real estate activity in Louisville was less robust in the fourth quarter of 2012 compared with the improvement in the first half of 2012. The vacancy rate in the fourth quarter increased by 70 basis points to 15.6 percent compared with a year ago (see table). A contact in Louisville noted that these changes can be explained by the openings of several new office buildings in the past three months of the year and by the less-satisfying performance in the Central Business District.
- Commercial and industrial construction remains active. Contacts reported that several commercial construction projects are under way in the Bowling Green area. A large amount of industrial space was also added due to new construction in the fourth quarter.

Non-residential market (Louisville, Q4-12)	Apartment	Office	Retail
Vacancy rate (%)	4.5	15.6	10.3
Asking rent	3.0	0.9 ▲	0.8
<i>Percent change from one year ago</i>			

Source: Reis.com.

Residential market (Q4-12)	Louisville	Clarksville	Elizabethtown	Evansville	US
CoreLogic Home Price Index	0.5	1.1 ▼	-5.7	1.2	7.4 ▲
Single-family building permits	38.6	-2.1	2.9	17.7	24.3
New and existing home sales	16.0 ▲	--	--	--	11.1

Note: Values are percent change from one year ago. Arrows indicate a significant ( $\pm 1$  standard deviation) change from previous quarter. See appendix for notes and sources.

## Auto Debt Is Above Pre-Downturn Levels

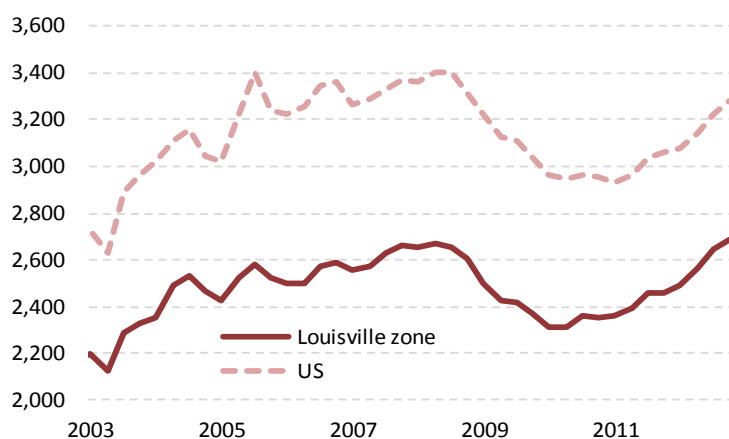
By Bryan Noeth, *Policy Analyst*

*“Our customers seem to be paying down debt and reducing the remaining terms of their mortgages through refinancing.”*

— Louisville area mortgage lender

### Auto debt continues to grow

*Auto debt per capita, dollars*



Source: FRBNY Consumer Credit Panel, Equifax.

- Income was up in the Louisville zone, increasing by 3.7 percent and 2.8 percent for Indiana and Kentucky, respectively. The rate of growth slowed, partly due to a decrease in earnings of government workers.
- Mortgage debt grew modestly in the Louisville zone over the past year. In fact, the fourth quarter was the first time that mortgage debt levels increased in the zone since 2009.
- Rates of seriously delinquent mortgages continued to fall and remain well below the national average, but above pre-crisis levels.
- Over 2012, consumers shed 2.3 percent of their credit card debt in the Louisville zone. The rate of decline has slowed since 2010, when borrowers were decreasing credit card debt at 9.6 percent annually.
- Increased auto sales led consumers to take on more auto debt, continuing the upward trend that began in the second quarter of 2010 (see chart). Auto dealers surveyed noted that January 2013 had been especially busy.

	Louisville Zone	Indiana	Kentucky	US
Per capita personal income (Q3-12)	--	3.7	2.8	2.5
Per capita debt balances (Q4-12)				
Mortgage	0.4	-1.2	-0.3	-2.9
Credit card	-2.3	-6.0 ▼	-4.2 ▼	-3.4
Auto loan	9.3	8.7	8.1	7.1
90+ day delinquency rates (Q4-12) (%)				
Mortgage	2.7	3.3 ▼	2.7 ▼	4.9 ▼
Credit card	6.6	7.6	7.2	10.0
Auto loan	2.9	3.4	3.1	3.7 ▼

Note: Unless otherwise noted, values are percent change from one year ago. Arrows indicate a significant ( $\pm 1$  standard deviation) change from the previous quarter. See appendix for notes and sources.

## Performance Has Improved but Bankers Still Waiting on Healthier Loan Demand

By Michelle Neely, *Economist*

*“The overall market place is healthier, but things are still fragile and businesses are very risk averse.”*

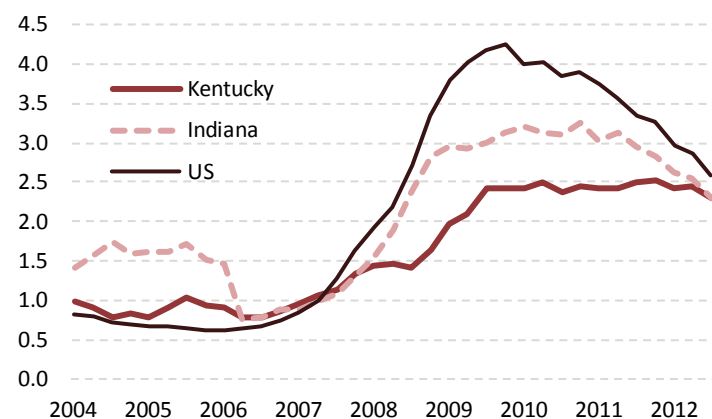
— Southwest Kentucky banker

*“We are getting a few more requests for loans; however, the qualifications from the applicants are weak for today’s underwriting standards.”*

— Western Kentucky banker

### Loan delinquency rates have converged

Nonperforming loan ratio at commercial banks, percent



Source: FRED.

- Most Louisville area bankers surveyed expect loan demand and loan delinquencies to be unchanged during the next three months.
- Kentucky and Indiana banks continue to outperform their District and U.S. peers in measures of profitability. Return on average assets (ROA) was up 38 basis points at Kentucky banks and 23 basis points at Indiana banks from year-ago levels.
- Large declines in loan loss provisions more than offset small drops in net interest margins at both sets of banks, mirroring the trends at the District and national level. Asset quality improvements are providing the major boost to earnings nationwide.
- Nonperforming loans declined at Kentucky and Indiana banks in the fourth quarter. The average nonperforming loan rates for banks in these states remain below the national average, though the gap between these states and the rest of the nation has narrowed (see chart).
- Loan loss reserve coverage ratios also improved at Kentucky and Indiana banks; banks in both states had an average of 75 cents in reserve for every dollar of nonperforming loans at year-end 2012.

Banking performance (Q4-12)	Kentucky	Indiana	8th District	US Peer Banks
Return on average assets	1.03 ▲	1.12	0.93	0.97 ▲
Net interest margin	4.01	3.92	3.90	3.87
Nonperforming loans / total loans	2.29 ▼	2.29 ▼	2.32 ▼	2.59 ▼
Loan loss reserve coverage ratio	75.12	75.06	79.89	71.78

Note: Values are percentage points. Arrows indicate a significant (± 1 standard deviation) change from the previous quarter. See appendix for notes and sources.

## Kentucky, Indiana Hit Hard by Drought, Expect Large Crop Insurance Payouts

By Brett Fawley, Senior Research Associate

*“Drought will have a large negative impact on our row crop (corn and soybean) producers and cattle producers, but at present it looks like tobacco (burley) will be up this year.”*

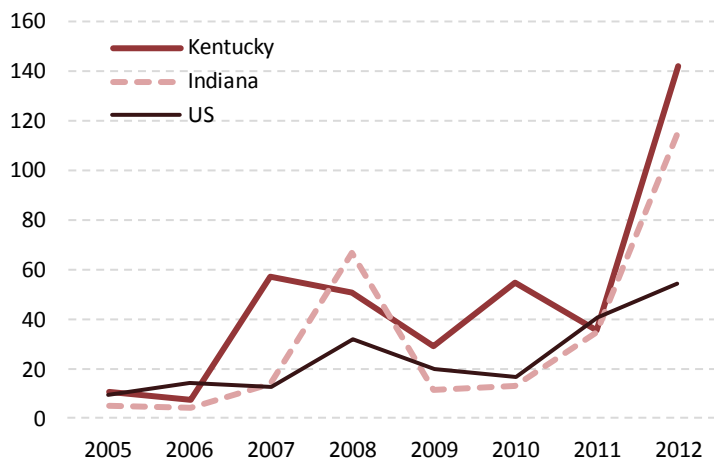
— Kentucky agricultural banker

*“The overall impact of the drought on the level of income for grain producers is going to be minimal. By the time the fall price is set on crop revenue insurance, our producers will see incomes near to slightly above spring income estimates.”*

— Indiana agricultural banker

### Crop insurance will ease negative income shock

Federal insurance payout, dollars/net acre insured



Source: FCIC.

- Higher local prices offset some of the decrease in production in Indiana and Kentucky. The dollar value of soybean production increased by 7 and 19 percent in Indiana and Kentucky, respectively.
- Federal crop insurance covered roughly 70 percent of the acres planted in Indiana and 50 percent in Kentucky. As of early March, the Federal Crop Insurance Corporation has paid out \$1 billion and \$420 million to Indiana and Kentucky farmers, respectively, or \$700 million and \$320 million more than it paid on the 2011 crop.
- Despite pessimistic expectations for the fourth quarter, Ag. bankers surveyed indicated that farm income, spending, loan availability, and the rate of loan repayment were all on par with or higher than one year ago.
- Indiana and Kentucky farmers planted 28.6 and 3.5 percent more winter wheat in 2012 than in 2011, respectively. The number of acres planted in Indiana remains 22 percent below the peak levels of 2008, while Kentucky planted 3.5 percent more winter wheat than it did in 2008.
- Coal production in 2012 in the zone’s states (excluding eastern Kentucky) was roughly similar to 2011. In the most recent quarter, Indiana coal production was down 6.5 percent and western Kentucky coal production was down 4.7 percent, relative to one year ago (see left table).

	Indiana	Kentucky	US	Louisville zone Ag. bankers' expectations Q1-13 vs. Q1-12		
Natural resources (Q4-12)				Lower	Higher	Net
Mining and logging employment	-3.9	-6.6	3.2 ▼	0	38	38
Coal production	-6.5	-4.7 ▲	-10.2 ▼	0	25	25
Crop production (2012)				0	0	0
Corn	-28.9	-42.4 ▼	-12.8	14	14	0
Cotton	---	---	9.2	14	14	0
Rice	---	---	7.9 ▲	14	14	0
Sorghum	---	---	15.2	14	14	0
Soybean	-7.1	1.9	-2.5	14	14	0

Note: Values are percent change from one year ago. Kentucky coal production refers to western Kentucky. Arrows indicate a significant ( $\pm 1$  standard deviation) change from the previous quarter. See appendix for notes and sources.

Note: Percentage of responses. See appendix for notes and sources.



## New Accounting Standards Set to Change the Pension Landscape

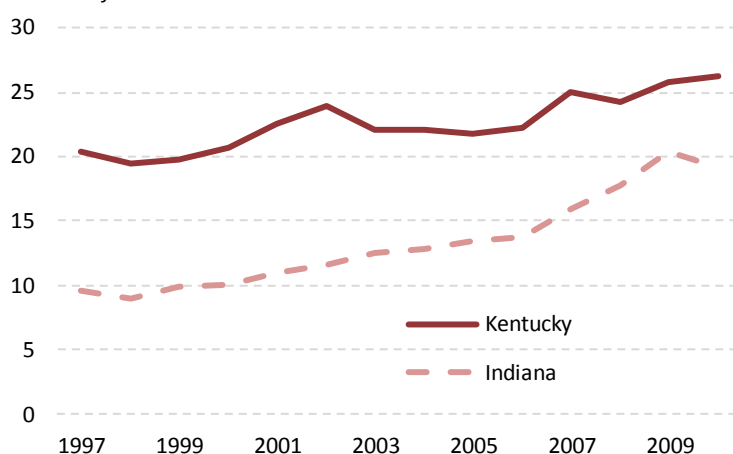
By Lowell R. Ricketts, *Senior Research Associate*

*“Through the years, all of the cities have paid in what we were told to pay. We sort of feel like we are caught in the middle of this. We haven’t failed to do anything, but yet we are going to have to show a liability.”*

— Dan Kemp, Mayor of Hopkinsville, KY

### KY has the highest percent of govt. debt in District

Percent of Gross State Product



Source: Census and BEA.

- Third-quarter tax revenues grew at a healthy rate for both Kentucky and Indiana. Corporate income tax revenue recorded strong positive growth, but weaker growth in sales and other tax revenue moderated overall gains.
- Local government employment was the only part of the public sector that has expanded in both Indiana and Kentucky. Consistent with the trend across the District, federal government payrolls in both states and in Louisville decreased in the fourth quarter.
- Of the Eighth District states, Kentucky has the highest percent of total government debt relative to gross state product (see chart). Total government debt in fiscal year 2010 was 26.2 percent of GSP, well above the average (16.9 percent) for the District states.
- Local government debt in Kentucky already encompasses 17.2 percent of gross state product. This is significantly higher than other district states.
- Only 54 percent of Kentucky’s public sector pension obligations are funded. New accounting rules take effect July 1, 2014 (see quote); that will require local governments, public agencies, and other public employers to reflect their portion of overall pension debt on their financial documents. This will expand liability estimates of public pension funds.

	Louisville	Kentucky	Indiana	US
Tax revenue (Q3-12)	--	3.9	3.5	2.8
Personal income	--	1.8	4.6	4.3
Corporate income	--	13.8	8.2	6.9
General sales	--	-1.0	3.4	3.3
Other sources	--	10.3	0.3	-0.3 ▼
Government employment (Q4-12)	0.1	-0.1	1.1	-0.4
Federal	-1.7	-2.9	-2.7	-1.5
State	1.0	-0.2	3.8 ▼	-0.1
Local	0.1	0.5	0.5	-0.3

Note: Values are percent change from one year ago. Arrows indicate a significant ( $\pm 1$  standard deviation) change from the previous quarter. See appendix for notes and sources.

## Cover Page

### Sources

*Bureau of Labor Statistics*

Unemployment rate, nonfarm payroll employment.

## Labor Markets

### Table Sources

*Bureau of Labor Statistics*

Unemployment rate. Nonfarm employment and contributions by sector.

### Notes

**Goods-producing sector** comprises the manufacturing and natural resources, mining, and construction sectors.

**Private service-providing sector** includes the following sectors: Trade, Transportation, and Utilities; Information; Financial Activities; Professional and Business Services; Education and Health Services; Leisure and Hospitality; and Other Services.

**Unemployment rate** data are seasonally adjusted.

## Manufacturing

### Table Sources

*Bureau of Labor Statistics*

Manufacturing employment: total, durable, and nondurable goods.

*Bureau of Economic Analysis*

Manufacturing earnings: total, durable, and nondurable goods.

### Notes

**Durable goods manufacturing sector** is defined by the Bureau of Labor Statistics as industries with a NAICS classification code of 321 (Wood Product Manufacturing); 327 (Nonmetallic Mineral Product Manufacturing); 331 (Primary Metal Manufacturing); 332 (Fabricated Metal Product Manufacturing); 333 (Machinery Manufacturing); 334 (Computer and Electronic Product Manufacturing); 335 (Electrical Equipment, Appliance, and Component Manufacturing); 336 (Transportation Equipment Manufacturing); 337 (Furniture and Related Product Manufacturing); and 339 (Misc. Manufacturing).

**Nondurable goods manufacturing sector** is defined by the Bureau of Labor Statistics as industries with a NAICS classification code of 311 (Food Manufacturing); 312 (Beverage and Tobacco Product Manufacturing); 313 (Textile Mills); 314 (Textile Product Mills); 315 (Apparel Manufacturing); 316 (Leather and Allied Product Manufacturing); 322 (Paper Manufacturing); 323 (Printing and Related Support Activities); 324 (Petroleum and Coal Products Manufacturing); 325 (Chemical Manufacturing); and 326 (Plastics and Rubber Products Manufacturing).

**Manufacturing earnings** is the sum of wage and salary disbursements, supplements to wages and salaries, and proprietors' income less contributions for government social insurance.

In the **contributions to employment chart**, bars represent the respective contribution of each sector to the area's total employment as a percent change from one year ago, while the line represents the net percent change from one year ago in total employment.

## Real Estate and Construction

### Table Sources

*CoreLogic*

Home price index, including distressed sales.

*Census Bureau*

Year-to-date single-family building permits.

*National Association of Realtors*

Year-to-date new and existing home sales.

### Notes

**Asking rent** is the publicized asking rent price. Data are in current dollars.

**Vacancy rate** is the percentage of total inventory physically vacant as of the survey date, including direct vacant and sublease space.

**New and existing home sales** consists of single-family home sales.

## Household Sector

### Table Sources

*Equifax based on authors' calculations*

All figures are based on a 5 percent sample of individual credit reports. Balances are geographical averages of various debt categories. The mortgage category includes first mortgages and home equity installment loans, but home equity lines of credit are omitted. Auto loans include those financed by finance company or bank loans. Credit cards are revolving accounts at banks, bankcard companies, national credit card companies, credit unions, and savings and loan associations.

*Haver Analytics*

Per capita income.

*Census Bureau*

Homeownership rates.

### Notes

**The CredAbility Index** is a quarterly measure of the financial condition of the average consumer. The scores are defined as follows: 90-100 implies excellent or secure, 80-89 implies good or stable, 70-79 implies weakening or at risk, 60-69 implies distressed or unstable, and 59 or below implies emergency or crisis.

**Delinquency rates** are calculated as the percentage of payments past due by more than 90 days, weighted by the dollar value of the loan.

**Homeownership rates** are the proportion of households in each area that are owners. It is calculated by dividing the number of households that are owners by the total number of occupied households.

## Banking and Finance

### Table Sources

*Federal Financial Institutions Examination Council*

Return on average assets: USL15ROA. Net interest margin: USL15NIM. Nonperforming loans: USL15NPTL. Loan loss reserve/Total loans: USL15LLRTL. Net loan losses/Average total loans: USL15LSTL.

Note: The data available in the table can be found in FRED.

### Notes

**Loan loss provisions** are expenses banks set aside as an allowance for bad loans.

**Nonperforming loans** are those loans managers classify as 90 days or more past due or nonaccrual, which means they are more likely to default.

**Loan loss coverage ratio** is loan loss reserves divided by nonperforming loans.

**US peer banks** are those commercial banks with assets of less than \$15 billion.

Due to the seasonal nature of bank return on average assets and net interest margin, the **arrows** in the table denote significant changes from one year ago.

## Agriculture and Natural Resources

### Table Sources

*Federal Reserve Bank of St. Louis Survey of Agricultural Credit Conditions*

Agriculture Bankers' expectations of loan demand, available funds, loan repayment rates, farm income, and capital expenditures are relative to one year ago. Respondents can answer "increase," "decrease," or "no change."

*Energy Information Administration (EIA)*

Coal production.

*Bureau of Labor Statistics (BLS)*

Mining and logging employment.

*USDA*

Crop production.

## Public Sector

### Table Sources

*Bureau of Labor Statistics*

Government employment: federal, state, and local. Private nonfarm employment.

*Census Bureau*

Tax revenue: total, personal income, corporate income, general sales, and other sources.

*Pew Center on the States*

Public sector pensions.

### Notes

Approximately 35 percent of Kentucky's (31 percent of Indiana's) **tax revenues** come from income taxes, 30 percent (45 percent) from sales tax, and 6 percent (6 percent) from corporate income taxes. The remaining tax revenues are from other sources.

**Required contribution** is the annual amount state actuaries recommend that states contribute to retirement funds in order to fully fund those promises over the long term.

**Unfunded liability** is an outstanding financial obligation that is not covered by state financial assets.